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THE FORBES MONEY GUIDE

JUNE 27, 1988 THREE DOLLARS SEVENTY-FIVE CENTS

Forbes

WHERE TO FIND INVESTMENT VALUES NOW

OUTSPOKEN JUDGMENTS ON ☞ STOCKS ☞ BONDS ☞ MUTUAL FUNDS ☞ REAL ESTATE ☞ GOLD ☞ RETIREMENT TAX TACTICS ☞ TECHNOLOGY ☞ COMPUTERIZED INVESTING ☞ INTERNATIONAL INVESTING

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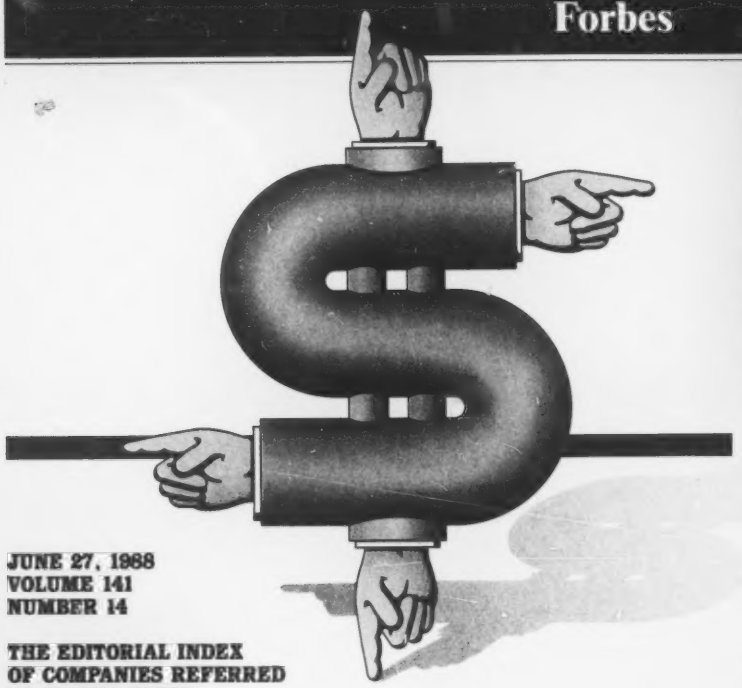

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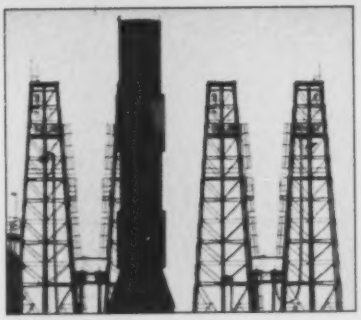

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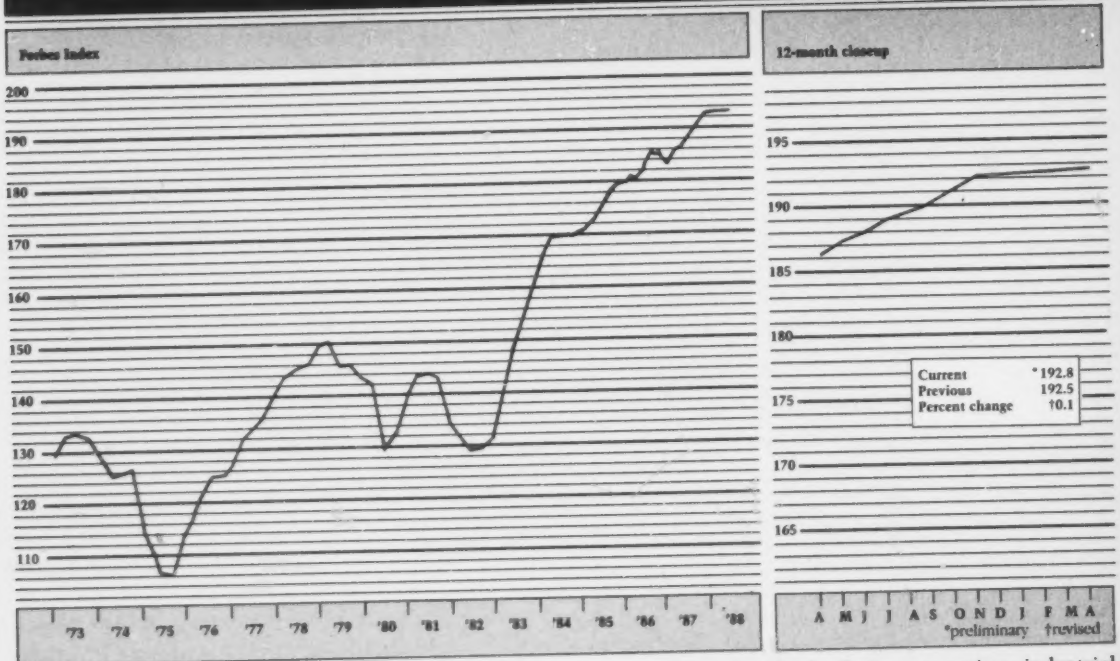
The Forbes Index



Some good news—undercut. Thanks to surging exports, the U.S. trade deficit narrowed dramatically in March. At $9.75 billion, the gap was the lowest in three years. Further improvement is likely, provided the dollar continues trading near its recent lows. The good news for U.S. exporters is undercut, of course, by higher prices paid by American consumers on imports.

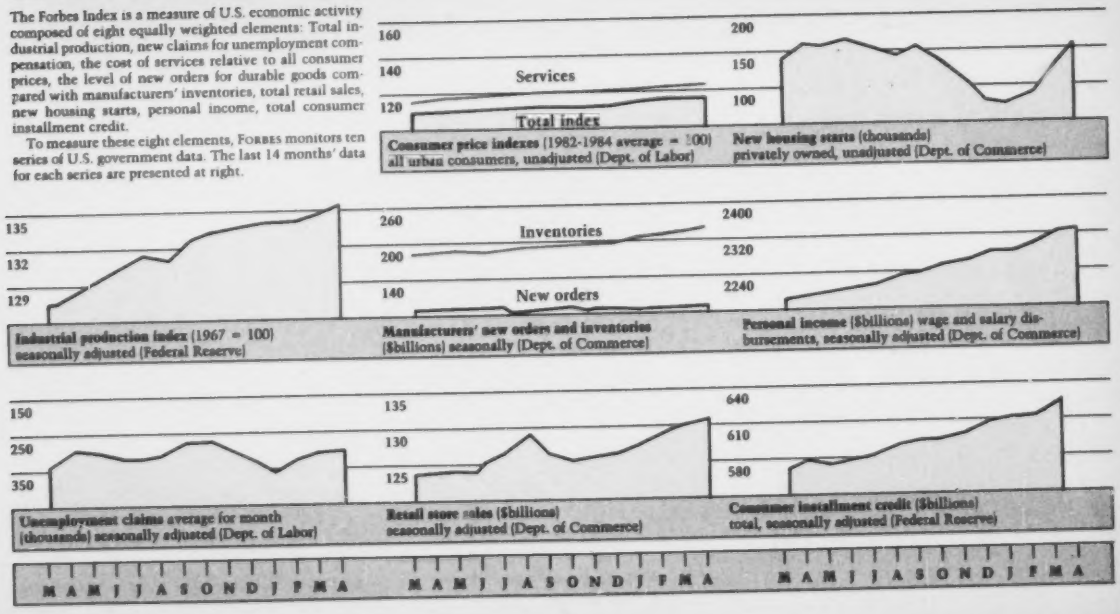
Following a period of relative stagnation, industrial production jumped 0.7% in April, while manufacturers' new orders increased for the third straight month.

The revised first-quarter figure for the gross national product shows real (after inflation) economic growth at an annual rate of 3.9%. The earlier estimate was only 2.3%. The preliminary Forbes Index for April was up 0.2%.

The Forbes Index Components

The Forbes Index is a measure of U.S. economic activity composed of eight equally weighted elements: Total industrial production, new claims for unemployment compensation, the cost of services relative to all consumer prices, the level of new orders for durable goods compared with manufacturers' inventories, total retail sales, new housing starts, personal income, total consumer installment credit.

To measure these eight elements, FORBES monitors ten series of U.S. government data. The last 14 months' data for each series are presented at right.


160
140
120
Services
Total index
Consumer price indexes (1982-1984 average = 100) all urban consumers, unadjusted (Dept. of Labor)
200
150
100
New housing starts (thousands) privately owned, unadjusted (Dept. of Commerce)
135
132
129
Industrial production index (1967 = 100) seasonally adjusted (Federal Reserve)
260
200
140
Inventories
New orders
Manufacturers' new orders and inventories ($billions) seasonally (Dept. of Commerce)
2400
2320
2240
Personal income ($billions) wage and salary disbursements, seasonally adjusted (Dept. of Commerce)
150
250
350
Unemployment claims average for month (thousands) seasonally adjusted (Dept. of Labor)
135
130
125
Retail store sales ($billions) seasonally adjusted (Dept. of Commerce)
640
610
580
Consumer installment credit ($billions) total, seasonally adjusted (Federal Reserve)
M A M J J A S O N D J F M A
M A M J J A S O N D J F M A
M A M J J A S O N D J F M A

"Shirtsleeves to shirtsleeves in three generations," said Andrew Carnegie. Why is it so hard to preserve capital? Why does family wealth dissipate in so few generations?

Preserving the family fortune

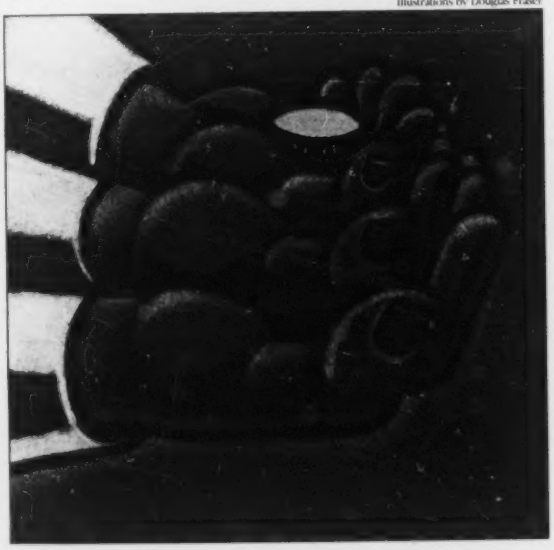
By Edward F. Cone

NOT EVEN Dick Freeman's funeral could bring his family together again. His sister, Mary Wisdom, and her children made a point of avoiding the front of the church where the rest of the family sat during the service in January 1985. With a lawsuit in progress and the Freemans publicly blaming their cousins for Dick's death, not even the starkness of death could heal the rift. How did one of New Orleans' most prominent families arrive at such a pass? Money. A feud erupted over the family's $150 million fortune, which had been amassed by an earlier generation and seemed destined to be dispersed as it was handed down to the next.

Ironically, the very act that sundered the family slowed the dissipation of the family fortune. By cutting their cousins, the Wisdoms, out of the succession, the Freemans had insured that only 11 members of the fourth generation, rather than over 20, would be sharing the wealth. That simple act of almost halving the number of heirs probably will keep the Freemans rich for a generation or two longer than otherwise. But this was a reprieve, not a pardon.

"Shirtsleeves to shirtsleeves in three generations," said Andrew Carnegie, the steel man who was the equivalent, in today's dollars, of a self-made billionaire. Why is it so hard to preserve a family fortune in the U.S.? Only a handful of families in the Forbes Four Hundred trace their wealth back before the Civil War. Our aristocracy is quite different from that of Europe, where wealth often lasts for several centuries. To cite just one example: The French-Swiss Hottinger family, which runs the Helvetia Fund, is in its seventh generation at the helm of a powerful private bank.

Illustrations by Douglas Fraser



One reason for the difference is the near absence of primogeniture in the U.S. But that is only part of the story. Old World wealth was for many centuries almost synonymous with land. If you lived off the land but never dipped into capital—never sold any of it—you could pass on the estate intact to the next generation.

The Schumpeterian dynamism of our economy, in contrast, has brought the nation great prosperity, but it has made static fortunes all but impossible. There is no buy and hold here. The prime lease of the previous generation may be the decaying central city of the present one. Today's premier software manufacturer may be tomorrow's Chapter 11. Whereas Old World wealth was at risk chiefly through war, revolution and the gambling table, today's U.S. wealth is at risk from every direction, and every day.

Does this concern only the superrich? Not at all. The same principles hold for the small nest egg and for the mighty fortune. The price of wealth today is an eternal vigilance. There are no one-decision stocks—investments that you can buy, put in a strongbox and just forget about.

The Wisdom family, into which the Freemans married in 1929, had old money dating to before the Civil War, made mostly trading cotton and tobacco. That money had largely petered out, but then a Freeman got lucky—or smart. In 1910 Alfred Bird Freeman, a former passenger agent for the Southern Railroad, put most of his meager savings into a bottling factory that had already failed twice. He eventually assumed control for a sum probably short of $20,000. It could have been foresight or it could have been dumb luck that he did not buy a horse halter manufacturer or a milk delivery route. What he got instead, along with the primitive bottling machinery, was the right to sell Coca-Cola in and near New Orleans.

It was this asset, the Louisiana Coca-Cola Bottling Co., that his grandchildren were squabbling over. At the urging of Dick Freeman, A.B.'s son, and Dick's sons Louis and Richard, the Wisdoms sold their sizable stake back to the company treasury at $950 per common share in 1983. Not long afterward, the Freemans sold the entire company to Coca-Cola for $150 million, or $6,750 per share. (The Wisdoms sued and in a settlement recouped an undisclosed fraction of what they lost out on.)

The Freemans' good fortune, however, has to be considered something

of a fluke. They latched on to one of the great success stories of this century, Coca-Cola. How have other fortunes fared?

Andrew Carnegie gave away most of his fortune. But what if he had had an heir who wanted to take over the family business? Chances are that the great fortune would not be intact today. Integrated steel plants in 1901, when Carnegie sold out to J.P. Morgan to create U.S. Steel, were like Coke bottlers are today: gold mines. They didn't stay that way for long. A $1,000 investment in U.S. Steel 71 years ago is now worth, in 1917 dollars, about $466—from which would come inheritance taxes and generational divisions and subdivisions. The asset simply didn't hold up. Unless renewed by an energetic descendant or through shrewd redeployment of assets, the Carnegie fortune would no longer exist even if it hadn't been given away.

How about the Rockefeller fortune, once one of the greatest? Old John D. was worth almost a billion in 1915, from a standing start a half-century earlier. Oil was surely the can't-miss business of the day. Today more than 80 descendants share perhaps $4.5 billion. If the family had merely kept up with the Dow over the past 70 years, it would have $20 billion today. Even allowing for the fact that John D. gave away half his fortune and his son gave away a lot too, the fortune hasn't held up too well.

The Mellons of Pittsburgh? They accumulated fabulous wealth in banking and aluminum. But neither Aluminum Co. of America nor Mellon Bank has been a good investment over the past 20 years. The Weyerhaeusers of Seattle? They are still very rich, but timber shares are no foolproof inflation hedge. Weyerhaeuser stock has lost one-third of its purchasing power in the past 15 years. The du Ponts first acceded to wealth in the early 1800s, although it might not have lasted much beyond World War I but for a very astute switch in the family's business from gunpowder into synthetics.

Family fortunes, then, are anything but secure in a family business. Is it better to sell out and invest the proceeds in a diversified portfolio? That was the decision 14 years ago of one Midwestern machinery manufacturing executive, who asked for anonymity. "I didn't see anyone else in the family who could run the company," he says. "I was the last of the Mohicans." He persuaded his cousins to accept an offer from a bigger company. He put the $140 million proceeds in a family holding company, where a cautious dividend policy has preserved the principal against the ravages of inflation. The pot is now about $500 million.

It is not easy, however, both to maintain an estate and live well off it. Money is not necessarily self-nurturing, and part of the income must usually be reinvested to repair the damage done by inflation, unforeseen changes and bad investments.

Consider one well-known trust that has faced minimal income taxes over the years and no increase in the number of its beneficiaries, yet has not kept up its payouts. That is the endowment left by Alfred Nobel to fund five prizes. The chart above shows what has happened. Although the endowment has recently returned to its original value, thanks to a runup in the Swedish stock market, the prizes being handed out today are worth only half what they used to be. The managers of the endowment erred probably only in being a little too conservative. Investments were largely in bonds and timberlands in the early years. Diversification into stocks, real estate and foreign securities has been fairly recent.

Tucking a fortune away in ultrasafe securities—say, government bonds—is no way to preserve it, at least if the entire income is to be spent every year. Inflation will eat into the principal. If inflation keeps up its pace since the 1930s, it will wipe out 90% of the dollar's value in only two generations.

Gold? That is an ideal inflation hedge *(see story, p. 190)*, but it has no yield.

How would a trust invested solely in U.S. stocks do? The chart in the following foldout tells that story. In real (inflation-adjusted) terms, the prices of stocks have trended irregularly but unmistakably higher over the past several generations. What counts, though, is their income-producing ability—the dividend level. Dividends keep going up, but adjusted for inflation, they have scarcely budged in the past quarter of a century. It appears, then, that a well-husbanded estate invested in average U.S. stocks could maintain its value for a long time—if not for taxes and a likely increase in the number of heirs along the way. Those factors make the battle for many families all but unwinnable.

What is the best way to preserve a fortune in the U.S.? Probably the only sure way is to have intelligent heirs. If they are astute and driven executives who are capable of running the family business for as long as that makes sense and of redeploying assets when the time comes, only then can they win the battle against inflation and economic change.

The same is true of smaller portfolios over shorter periods: There is no sure, safe way to preserve wealth, let alone to enhance it. It takes nerve, careful study, unemotional investments and good timing. The articles in this issue are a good place to start the study—but you yourself will have to do the work. ■

The Nobel (inflation-adjusted) Prize

The prestige of the Nobel Prize is undiminished, but the value of the cash awarded to five laureates each year has declined greatly. Conservative trustees of the Nobel Foundation diversified beyond bonds and timber into stocks and real estate only lately.

*Adjusted to the 1987 Swedish price index and translated into dollars at recent exchange rates. Sources: Nobel Foundation, Skandinaviska Enskilda Banken.

OVERSIZE FOLDOUT(S) FOUND HERE IN THE PRINTED EDITION OF THIS VOLUME ARE FOUND FOLLOWING THE LAST PAGE OF TEXT IN THIS MICROFICHE EDITION.

SEE FOLDOUT NO i

Where you live affects how you should invest. In states where the politicians look on returns to savings as "unearned," for instance, Treasury bonds then become very attractive.

Beyond the 1040

By Gale Eisenstodt

WHAT IS THE WORST PLACE in the U.S. for an investor to live? That's a tough question, since there are two strong contenders for the award, New York City and Connecticut, and there is something bad to be said for each of them. New York City seems to have the worst possible marginal rate on investment income. There, the combined state and city marginal tax rate—the additional tax penalty for earning the last dollar of income—can get as high as 17.8% in unusual circumstances.* Connecticut's top tax bracket for investors is only 12%, but it affects a great many more people. You be the judge.

**The top city tax rate is 3.5% and the top state rate is 8.375%, plus a surcharge of up to 2% on investment income. The way the surcharge is calculated, however, throws a double whammy on people with income between $100,000 and $200,000. A single taxpayer with $198,500 of income, all interest and dividends, would see his tax go up $178 as a result of earning an additional $1,000.*

Time was when tax planning for the investor was built around the federal tax code, since rates there were so much higher than at the state level. The 1986 tax act changed all that. With the top federal bracket only 33% (28% for the richest taxpayers), state taxes loom larger. The benefit of deducting them on the federal return is smaller. Indeed, people who wind up paying the new federal alternative minimum tax don't get any federal benefit from state taxes. For them, Albany's reach goes deep into the pocket.

"State tax is more important in the planning of investments than it used to be," says Bruce Cobern, a tax manager at accountants Weber Lipshie &

Oink, oink!

If you live in Idaho, don't invest in a semiconductor factory; the legislature would rather you bought breeder pigs. Other states seemingly don't want you to save at all. Here is a guide to the highest tax rate in each state on portfolio income, as of May 30. Except as noted, rates are for joint returns and apply to taxable income as defined by the state.

State	Top 1988 tax rate on interest & dividends	Top 1988 tax rate on long-term capital gains
Alabama*	5% above $6,000	same
Alaska	none	none
Arizona*	8% above $14,000	same
Arkansas	7% above $25,000	same
California	9.3% above $47,900	same[1]
Colorado	5% flat rate	same
Connecticut†	12% above $100,000[2]	2.8% flat rate‡
Delaware	7.7% above $40,000	same
D.C.	9.5% above $20,000	same
Florida	none	none
Georgia	6% above $10,000	same
Hawaii	10% above $40,000	7.25% above $5,000[3]
Idaho	8.2% above $40,000	same[4]
Illinois	2.5% flat rate	same
Indiana	3.4% flat rate	same
Iowa*	9.98% above $45,000	same[5]
Kansas	5.3% above $35,000	same
Kentucky*	6% above $8,000	2.4% above $8,000‡
Louisiana*	6% above $100,000	same
Maine	8% above $30,000	same

Co. in New York.

And state tax planning is more complicated than it used to be, what with the flurry of state enactments in response to the new federal code. We present, in the table opposite, a rogue's gallery of state tax departments. But the rates shown are only a preliminary indication of relative tax burdens. North Dakota looks bad with a top 12% rate on dividends and interest, but the state leaves an out: In lieu of using the published schedule, the taxpayer can pay the state 14% of his federal tax liability. That effectively brings the maximum state bracket down to 4.6%.

If you live in Texas, Nevada, Alaska, South Dakota, Wyoming or Washington State and have only in-state investments, you can skip the table. But if you live somewhere else, or own a tax shelter or other partnership with properties in a state with a personal income tax, state taxes demand attention. Note that a number of states simply have it in for investors. Salaries are taxed lightly, while savings are hit hard. "Treatment of interest, dividends and capital gains is not one of the fighting causes in many states," says Steven Gold, director of fiscal studies for the National Conference of State Legislatures.

Massachusetts, for example, imposes a flat 10% tax on interest and dividends but only 5% on earned income. Connecticut and Tennessee exempt earned income altogether. In places like those it becomes doubly important to use Keogh and corporate thrift plans to the maximum extent possible. These forms of savings then do more than defer tax; they convert investment income into a more lightly taxed variety.

The complexities are endless. Seven states allow residents to deduct federal taxes from state returns, in a way that helps lower effective rates. Some states piggyback onto federal definitions of income, while others don't. In Idaho, real estate held for five years qualifies for a 60% exemption on capital gains taxes, but a breeder hog need be owned for just one year to get the exemption, unless it resides out of state.

Beware also of Florida's back-door income tax. The Sunshine State imposes an annual 0.1% wealth tax on portfolios. For a stock portfolio with an average yield, this is about the same as a 3% income tax.

Then there are limited partner-

Oink, oink!

State	Top 1988 tax rate on interest & dividends	Top 1988 tax rate on long-term capital gains
Maryland	5% above $3,000	3% above $3,000[6]
Massachusetts§	10% flat rate[7]	5% flat rate
Michigan	4.6% flat rate	same
Minnesota	8% above $19,000	same
Mississippi	5% above $10,000	same
Missouri*	6% above $9,000	same
Montana*	12.1% above $48,000[8]	same
Nebraska	5.9% above $45,000	same
Nevada	none	none
New Hampshire†	5% flat rate[9]	none
New Jersey	3.5% above $50,000	same
New Mexico	8.5% above $64,000	same
New York§	10.375% above $200,000[10]	8.375% above $34,000
North Carolina	7% above $10,000	same
North Dakota[11]	12% above $50,000	same
Ohio	6.9% above $100,000	same
Oklahoma	6% above $15,000	same
Oregon	9% above $10,000	same
Pennsylvania	2.1% flat rate	same
Rhode Island	22.96% of federal tax liability	same
South Carolina	7% above $10,000	same
South Dakota	none	none
Tennessee†	6% flat rate	none
Texas	none	none
Utah	7.75% above $7,500	same
Vermont	25% of federal tax liability	same
Virginia	5.75% above $15,000	same
Washington	none	none
West Virginia	6.5% above $60,000	same
Wisconsin	6.93% above $20,000	2.77% above $20,000‡
Wyoming	none	none

*State allows deduction for federal taxes, which usually helps lower effective rates. †State has no tax on earned income. ‡ After giving effect to 60% capital gains exclusion. §Rates on interest, dividends and capital gains are higher than those on earned income.

[1]Allows credit equal to 4.5% of gain from sale of instate rental residential or farm property.

[2]Applies to returns where federal adjusted gross income exceeds $100,000.

[3]If an individual's income including the capital gain is taxed at a rate in excess of 7.25%, the capital gain is taxed at only 7.25%.

[4]60% exclusion allowed for instate assets: realty held 5 yrs; tangible personal property used by a revenue producing enterprise—manufacturing, timber, farming—held 6 months; cattle or horses held 24 months; other breeder livestock held 12 months; timber held 24 months.

[5]60% exclusion allowed on first $17,500 for most investors.

[6]Effective rate after allowing 40% exclusion of capital gain.

[7]Interest and dividends on instate savings account taxed at 5%.

[8]Includes 10% surcharge.

[9]$1,200 of interest and dividends exempt.

[10]Consists of 8.375% marginal rate beginning at $34,000 plus flat tax up to 2% on all dividend and interest income above $200,000 of New York adjusted gross income (AGI). The 2% flat tax phases in between $100,000 and $200,000 of New York (AGI).

[11]Taxpayers may elect alternate method of 14% of federal tax liability.

Source: National Conference of State Legislatures.

ships, which are fraught with pitfalls. Grant Thornton partner Thomas Ochsenschlager points out that if you own shares of a partnership, or even of a publicly traded master limited partnership, you may have to file and pay taxes in every state where the partnership does enough business that you exceed filing minimums. So if you bought shares of Servicemaster, L.P. and you've retired to Florida, you may have to file in dozens of states where the company does business.

Ochsenschlager recalls an unfortunate District of Columbia resident with an interest in an Oklahoma oil well who didn't file Oklahoma returns and in the end was double-taxed for several years of royalty income. He owed taxes and interest for his misdeed and, as a final sting, couldn't claim the Washington credit for taxes paid to another state. By the time the taxpayer paid up in Oklahoma, his returns could no longer be amended.

What's a poor investor to do? One strategy is to buy U.S. Treasury bills, notes or bonds, which are universally exempt from state tax, including the Florida wealth tax.

Another is to buy municipal bonds from your home state, which are generally exempt from state and local income tax (Illinois, Iowa, Kansas and Wisconsin are exceptions to this rule). Many large mutual fund houses offer single-state tax-exempt bond funds that invest solely in munis from one state. Such funds exist for over a dozen states and New York City. Obviously, the tactic will make more sense if you live in California than if you live in Pennsylvania. And beware that you don't sacrifice more in high sales charges and low performance than you save in taxes.

Still another strategy is to vote with your feet. If you are going to retire to Florida and you are sitting on a lot of capital gains, move before liquidating your portfolio. ■

Before you retire or take a distribution from your corporate thrift plan, be sure to study the tax laws. Also get professional help.

Retirement tax strategy

By Laura Saunders

TAKE IT FROM Leon Nad: Figure your taxes before you retire. "For the typical retiree, these are the most important financial decisions he or she will make," insists the tax sage of Price Waterhouse, who is himself retiring at 60 in June.

Why? Because so much money is at stake. At retirement, you typically receive at least part and maybe all the assets that have been building up in your name for years in tax-deferred ("qualified") retirement plans. The sum can easily run to the hundreds of thousands or even millions of dollars.

Thanks to Congress' persistent meddling, these disbursements are subject to tax laws of staggering complexity. Penalties for mistakes are high. Even worse, notes Price Waterhouse tax expert Robert Wagman, "the most important decisions are often irreversible."

Chas. B. Slackman

A San Francisco executive Wagman knew of took a three-month trip to Europe at the wrong time. Soon after he left he received a $600,000 profit-sharing settlement. The man was going to roll the money into an Individual Retirement Account. But the IRS' deadline for rollovers is a strictly enforced 60 days. Tax due: about $250,000. An expensive trip.

The moral is that where taxes and retirement are concerned, get expert help. Read this guide and, if you want, the impenetrable IRS publications 560, Self-Employed Retirement Plans; 575, Pension and Annuity Income; and 590, Individual Retirement Arrangements. Such study will be merely a warm-up for a consultation with an expert.

Yes, you can find a money manager who'll handle your $100,000 account. But you might be much better off in a mutual fund.

Professional help

Phil Huling

By Jonathan Clements

FOR A DECADE, Erland Construction's $700,000 profit sharing fund languished in certificates of deposit and Treasury bills. The fund's trustees twice tried to find a professional manager, but both times gave up in confusion. "All I can remember are reams and reams of brochures and statistics that you just couldn't wade through," recalls Anne Feher, corporate treasurer of the Burlington, Mass. construction company.

The fund's bewildered trustees finally turned to Robert Barker, an E.F. Hutton vice president who matches investors with money managers. Barker helped the trustees select a local money manager who put the fund's assets into a conservative mixture of stocks, bonds and cash. "I turned over the money on the Friday before Black Monday, so they didn't have time to invest it," says Feher. "I guess we were lucky."

Erland's profit sharing fund, and $28 billion in similar accounts, helped Hutton's asset management division (now part of Shearson Lehman) gross $331 million last year in management fees and commissions. Shearson's "select" program doesn't pick stocks; it picks stock pickers, sharing with them a "wrap fee" of up to 3% of assets annually that covers commissions on trades and portfolio management fees. Shearson's other consulting service, the "suggest" program, has a $100,000 minimum and either charges a wrap fee or picks up "soft dollars" by having money managers funnel trades through Shearson.

A 3% fee for managing money is a little on the steep side *(see story, p. 260)*, but the success of the 15-year-old program is evidence that Shearson's money-manager-finders are filling a need. Out there are a lot of savers like Erland Construction who not only don't know how to pick investments but also don't know how to pick investment managers.

It's not easy to select a money manager. Today there are 4,500 investment advisers who will handle money on a discretionary basis, up by 1,200 in two years. Managers typically take an annual fee of 0.5% to 2% of assets, depending on the size of the account. With the exception of the Shearson select program's fairly unusual arrangement, they also usually run up brokerage commissions. Some of the pros earn back these costs by consistently beating the market averages. A lot don't, however, and their clients end up wishing they had bought a cheap index fund that merely tracked the averages.

Indeed, the first question any small investor should ask before picking a money manager—or having someone like a broker do it—is whether a manager is needed at all. With a modest annual fee of 1%, a $1 million account will generate $10,000, enough for some personal attention and perhaps even tax strategy. But what about a $100,000 account, the minimum needed for the Shearson select program? Even at a stiff 3%, that account will yield the manager only $3,000 a year, not enough for a lot of hand-holding and individualized portfolio strategies. And if what you get is a cookie-cutter portfolio, why not put the $100,000 into mutual funds? Plenty of good funds are available with fees, overhead and brokerage commissions running a lot less than 3% of assets annually.

When Heidi Steiger took over the individual asset management division of Neuberger & Berman in January 1986, she raised the minimum account size from $100,000 to $250,000. "At that point, the performance is very consistent, whether you're talking about a $250,000 account or a $20 million account," says Steiger. "Below $250,000, the performance is very spotty." The reason is simple: Small portfolios are difficult to diversify. Indeed, that's why mutual funds were invented. Their chief disadvantage is that they cannot pass capital losses through to shareholders.

"When you can go out and buy a no-

load with very low management expenses and a competitive record, I don't find it very compelling to go hire a manager for $50,000," argues Sandy Lincoln, a managing director with consultant Mercer Meidinger Hansen, a firm that helps pension sponsors find portfolio managers. "It's a waste of bucks."

If you have substantial assets—or if you have only $50,000 but are determined to ignore Lincoln's good advice—do what pension funds do: hire a consultant to find a money manager.

First question to ask: How will the consultant be paid? Some, like New York City's Wyatt Asset Services, charge a flat fee or an hourly rate. Wyatt's accounts are generally above $10 million, and carry fees of at least $15,000 for the selection of a portfolio manager and $8,000 annually for monitoring performance. There are, however, consultants whose accounts are much smaller. San Diego-based adviser Michael Stolper, for example, charges a minimum of $1,500 for finding a portfolio manager.

Retail brokers with a sideline as money-manager-finders often take much smaller accounts. They typically don't collect from the investor at all. Instead, they insist that the lucky manager who gets the account do his trading through the referring broker. Some nonbrokerage consulting firms take their pay in similar fashion, through soft dollars that allow them to share in commissions directed to a particular brokerage firm.

The problem with such an arrangement is that it gives the money manager an incentive to churn your account. If you go this route, you have the added burden of watching closely the turnover in the account. Set a limit on the dollar amount of brokerage fees that can be run up per year. A starting point for negotiation is the 3% wrap fee that Shearson's select program offers. Brokerage commissions plus money management fees should not exceed this percentage of your assets.

Once you have narrowed your search to one or two prospective managers, check them out. Money managers are usually willing to provide lists of satisfied clients, although such testimonials must be taken with a grain of salt. You'll never hear about their clients who lost money.

Next, ask for the money manager's ADV registration with the SEC. Part II shows résumés of the firm's principals and describes fees and management style. Part I lists criminal convictions and tells you whether the firm has ever had trouble with the SEC. Make sure that you get the whole ADV.

Next, ask for performance history. Alas, this must be taken with another grain of salt. A standing joke in the pension consulting industry is that there is no such thing as a bottom-quartile performance. How so? One trick is for the manager to present data only for those periods when he was beating the market. There are 1,001 other ways to fudge a performance record. Among them: excluding disgruntled ex-clients from the averages, weighting the averages according to what method gives the best-looking results, and publishing hypothetical results as if they were achieved with real money. In severe cases of underperformance the management firm can always go out of business and reorganize under a new name. The bad performance numbers simply disappear.

And then there is the outright lie. "Just today, I must have had two or three managers sending me information that is completely fabricated," says Bruce Hauptman, a Fairfield, Iowa consultant.

Aren't performance data filed with the SEC? Unfortunately, no. But large managers do file certain SEC documents from which reasonable guesses can be derived. Managers with at least $100 million in stocks and convertibles list their positions at the end of each quarter. Companies like Rockville, Md.-based CDA Investment Technologies use those filings to measure performance. CDA simply assumes that all positions held at the quarter's start are maintained unchanged for three months. The advantage to the CDA system is that managers would find it hard to doctor the numbers. The disadvantage is that it presumes a money manager is fully invested and ignores trading between quarterly statements. Over short periods, the CDA rankings are not too reliable. For long periods—three years and up—they seem to be the most unbiased performance data available. In the table we show the ten managers that were top-ranked by CDA over the past five years.

On very rare occasions, the SEC catches a money manager for fudging his record. Last year it charged that Max Zavanelli, a Chicago-area manager, cited investment results that included three years when no actual trades occurred. Zavanelli, who says he was paid for investment advice during those three years but didn't

By invitation only

The ten top managers over the past five years, as tracked by CDA Investment Technologies, can afford to be picky about their business. Most won't take accounts under $1 million, and some aren't accepting new money. The best is Mario Gabelli's Gamco. His advice is open to the public through the closed-end Gabelli Equity Trust, which trades at a discount to net asset value, and the open-end Gabelli Asset Fund. Ruane Cunniff runs the Sequoia Fund, but it is not accepting new shareholders.

Company/headquarters	Assets under mgmt ($mil)	5-yr annual return[1]	Minimum account[2] ($mil)	Fee for minimum account
Gamco Investors/New York	$1,010	26.7%	$1	1%
Ruane Cunniff/New York	733	24.3	—[3]	—[3]
Tweedy Browne Co L.P./New York	276	21.7	—[3]	—[3]
Southeastern Asset Mgmt/Memphis	457	20.7	10	0.85
Tukman Capital Mgmt/Larkspur, Calif.	239	20.6	2	1.75
First Manhattan Co/New York	3,486	20.3	none	1
Reich & Tang L.P./New York	1,066	19.6	20	1
Trinity Investment Mgmt/Boston	3,553	19.6	10[4]	0.85
Cashman Farrell & Assoc/Wayne, Pa.	596	19.5	1	1
Harris Associates L.P./Chicago	1,338	19.4	2.5	1
S&P 500		15.5		

[1]Ending March 1988. [2]If taxable. [3]Not accepting new accounts. [4]Smaller accounts accepted but minimum fee of $42,500 applies.

Source: CDA Investment Technologies

actually execute the trades himself, was barred from accepting new clients for 180 days. He thinks the SEC was just being overly zealous.

A final note on performance records: They are a very imperfect guide to future results. Equally important is the risk the manager takes to get his results, and whether you are comfortable with that level of risk. Perhaps the first question to ask is how well the average account did in the final quarter of last year, when the market crashed.

Once signed on with a manager, when should you bail out? Industry wisdom says a money manager should get three years or a market cycle to prove his worth. But consultant Stolper says that may be too long. "If you get into the second year and it's going to take an act of God to hit your objectives, you might as well leave."

Better still, try to get out before the numbers turn bad. Among the early warning signs are a change in the management company's ownership, a switch in your account representative without reasonable explanation, a change in the money manager's investment philosophy or the departure of key personnel.

If this sounds like too much work, consider the cheaper option, which is to buy a mix of mutual funds. ■

Investing deluxe

It's time to sell your racehorse stabled in France, but you simply can't find the time to close the deal. What to do? Why, turn to your trust officer.

Selling Thoroughbreds or yachts or homes in foreign countries is not Jack Church's primary business. But with a million-dollar account minimum at Philadelphia's Glenmede Trust Co., where Church is head of investments, customers can be demanding. "If we skimp on service, we're dead," says Church, 55. Not skimping—Church has arranged for all of the above transactions—has allowed his employer to reach $4 billion in assets under management, up from $1.2 billion in 1979, when Church came over from the trust department of a bank.

Sarah Leen

Jack Church of Glenmede Trust Co.
"If we skimp on service, we're dead."

There are others in the business of hand-holding for wealthy investors. One of the best known is New York City's Bessemer Trust, a family office originally run for descendants of steel baron Henry Phipps. Another is U.S. Trust Corp., a New York institution that has moved from commercial banking into trust work.

Glenmede did not exactly start from scratch. Well-heeled Main Line Pennsylvanians have known the company since its founding in 1956, when J. Howard Pew set it up to administer his family's charitable foundations. The assets in those seven trusts were made up mostly of stock in Sun Co., which Pew's father had started, along with holdings in Chilton Publishing and General Crude.

Glenmede's current incarnation came about almost by accident. International Paper bought General Crude in 1974, leaving Glenmede's board with the question of how to reinvest the cash. It decided to open a for-profit money manager, which would take outside business. Says Anderson Pew, 51, a great-grandson of Sun's founder and a member of both the Sun and Glenmede boards, "We felt there was a critical mass to be reached in terms of dollars managed." The critical mass has been reached. Glenmede, owned by Pew family members and top management, made a profit of about $1.4 million last year on revenues of $11.8 million.

Church knew where to find his customers, who pay a minimum of $10,000 a year, plus an additional $5,000 for the second and each subsequent million dollars. "Philadelphia is a trust-oriented city," he says. "Very conservative and very wealthy." His market was the disgruntled clients of Philadelphia's commercial banks, many of which have recently undergone mergers. "Our customers expect personal attention," says Church. And, evidently, a sense of humor. A caller who dials Andy Pew by mistake is told, "Right Pew, wrong Church."

Performance, seemingly a secondary consideration for the carriage trade, is not bad at Glenmede. Its Pew Memorial Trust has appreciated 17.5% a year over the five years ending December 1987, versus a gain of 16.4% for the S&P 500.—**Edward F. Cone**

How much trading is too much? Depends on whom you ask. Brokers with discretionary accounts are likely to consider a 200% annual turnover reasonable. (Meaning, if you have $100,000 in stocks, you do $200,000 of purchases and $200,000 of sales in the space of a year.) Now look at the table on page 258. One of the top-performing money managers, Ruane Cunniff, also runs the excellent Sequoia Fund (sorry, it's closed to new investors). Sequoia's average turnover in the past decade: 30% a year.

Arthur Levitt, American Stock Exchange chairman, has suggested brokers should work on retainers instead of commissions. In a sense, that's what Shearson Lehman Hutton does with its annual "wrap fee" on money management, where all fees and commissions are rolled into one percentage fee. No matter how active their buying and selling, clients pay 3% on assets up to $500,000, and less above that. Other brokerage firms have similar programs.

Another option for novices is a bank trust department. Minimums vary, but they are usually lower at small-town banks than big city banks. Accounts at Bridgeport, Conn.-based People's Bank start at around $250,000.

Fees? Many banks take 1% or so of assets annually. People's Bank takes a percentage of assets and a percentage of interest and dividend income. A $300,000 account generating $20,000 a year in income would run up $3,075 a year in fees. You will also pay commissions on the stocks and bonds the bank buys for you. Figure an extra 1% in startup costs for that, says Robert Langell, a trust officer at People's. But you could keep this cost low by urging that a large fraction of the account go into long-term Treasurys or municipal bonds bought new. As for commissions in subsequent years, they would probably be fairly low since banks lean to a buy-and-hold strategy. Unlike brokerage houses, they don't make trading their livelihood.) But nail down this point with the trust officer.

Beware the hidden commission. Planner Capelli tells of one client with $150,000 to invest. The client had happily received a "free" financial plan from an adviser, but the commissions to execute the plan totaled $12,000. If a broker boasts that a mutual fund has no upfront load, look for a back-end one. Typically such a load is coupled with an annual "12b-1" sales fee taken out before you see a dividend. New Securities & Exchange Commission rules require that such costs be spelled out toward the front of the prospectus.

If you have more than $250,000, you can hire an investment adviser for about 1% of assets annually plus commissions. Prudential-Bache Investment Management requires $500,000, and you pay 1% for equities or ¾% for bonds, plus commissions that generally total 1% or less a year, according to Jeffrey Laikind, the group's managing director. For accounts between $100,000 and $500,000, clients pay 3% of assets and no commissions.

Another possibility, for those who have some financial sense but don't want to pick stocks, is to find a stock manager for half the money and then manage the rest themselves, by buying and holding bonds. Michael Stolper, a San Diego consultant who finds money managers for rich people, encourages clients to do just that. People who follow his advice pay fees only on that part of their portfolio that requires active management.

Perhaps the cheapest, and least exciting, way to invest in stocks is by going into the Vanguard Index Trust, a no-load fund that mechanically duplicates Standard & Poor's index of 500 stocks. Annual overhead and management cost on $100,000: $270, including a $10 account fee. You're guaranteed never to beat the average, though.

Another relatively cheap way to manage money is by buying a few good no-load mutual funds (FORBES, *Sept. 7, 1987*). Or you can buy a good closed-end investment company when they sell—as they currently do—at substantial discounts from asset value. The only annual fee you pay is the regular management fee—often less than 1% of assets. That is not only cheap but it also gives you the advantage of having not one but a number of good advisers.

Whatever you do and whomever you choose, keep one essential fact in mind: Don't hire a broker or adviser and then just walk away. "Even those who don't want to get involved ultimately have to," says John Markese, director of research for the American Association of Individual Investors. You don't have to constantly second-guess your adviser, but you should know what he is doing and why. ■

If y really don't know what you're doing, y u can wind up paying two layers of fees t have your money managed.

Double dip

By Eric Schmuckler

A MUTUAL FUND is for someone who lacks the time or assets to pick his own stocks or who wants the additional diversification a fund can bring. What is there for someone who can't pick his own fund? A fund-picking service. Does such a service make any sense? Only for the truly helpless. And it costs a pretty penny.

The business is growing smartly. Some bank trust departments invest by investing in funds. Several newsletter writers, including Sheldon Ja-

cobs of the *No-Load Fund Investor* and William Donoghue of *Donoghue's MoneyLetter*, are now managing portfolios of funds.

Laziness and nervousness are the fund advisers' two chief selling points. "Many of our clients are busy professionals who don't even have time to go through their daily mail," offers Paula Dachis of Schabacker Investment Management, which collects a 0.6%-to-2% annual fee for helping clients pick funds.

Another key service a fund adviser provides is hand-holding. "When the market falls 100 points, you want to have someone to ask, 'Should I sell my funds now?' " says John Treat, head of Old Stone Financial Services, a subsidiary of Old Stone Corp., a Providence, R.I. thrift holding company. Old Stone maintains a list of recommended funds, the Old Stone 100, to assist the clients of financial planners. To get the benefit of Old Stone's wisdom you have to go through a financial planner and pay 2% in fees: 1% to Old Stone and 1% to the planner.

For smart investors, fund advisers are an utter waste of money. Why pay a point or two in fees—that could be several thousand dollars a year—to find the best funds when such information is widely available and easily understandable in FORBES' annual mutual fund survey and in many other publications and books?

Those in a position of fiduciary duty may want a consultant to blame if things don't work out. Admits fund adviser Kurt Brouwer: "People who hire us don't want responsibility. They want a pro watching." That's why small pension or profit-sharing plans are often clients.

So are financially naive individuals with a few hundred thousand dollars to invest—too small a sum for an individual managed account, too big to plunk into a single fund. For the novice investor, fund advisers also frequently perform rudimentary financial planning, such as assessing risk tolerance.

Some of the fund pickers, however, don't offer much hand-holding. They simply attempt to enhance returns by switching in and out of funds or among funds. They have to be very smart to add any value, since the customer is now swimming upstream against another 2% or 3% in annual costs.

Gary Henrie

And then there is the ultimate absurdity, the fund of funds. FundTrust, a group of four portfolios that invest in other funds, is the brainchild of Michael Hirsch, chief investment officer at Republic National Bank. Hirsch won't speak to FORBES because of a 1984 article he considers uncomplimentary,* but back then he justified the extra layer of expenses this way: "We will overcome the lethargy effect." By that he meant that fund shareholders often stick with a loser too long.

Maybe they do. The best of the four FundTrust funds has delivered an average annual return of 11.5% since its November 1984 inception, against the market's 16.7%.

Why so bad? One reason is the second layer of expenses, which ranged from 1.4% to 1.6% last year, on top of expense ratios on underlying funds. Also, FundTrust sometimes buys load funds, paying a commission of up to 1%. What's more, in February FundTrust tacked on a sales load of its own of up to 1.5%. You now have the dubious privilege of paying not only two expense ratios but two sales loads as well.

The moral here is quite simple, though it may not be what a lot of neophyte investors want to hear. It is that no one should invest who is not willing to do some homework on how to pick a fund you'd feel comfortable with. Delegating to someone else the task of picking a mutual fund is going to cost a lot of money and probably not produce results as good as you could achieve on your own. ■

* "The dumbest idea in years," FORBES, Dec. 31, 1984.

Manager managers

These managers don't pick stocks; they pick stockpickers. The extra layer of management often comes with an extra layer of fees.

Fund adviser headquarters	Assets under mgmt ($mil)	Fee
B.J. Group Hastings-on-Hudson, N.Y.	$15	1–2%
Brouwer & Janachowski San Francisco	90	0.25–0.75
Fabian Financial Huntington Beach, Calif.	110	3
FundTrust[1,2] New York	187	1.5 load 1.4–1.6 expenses
Old Stone 100 Providence, R.I.	50	2
Right Time Econometrics Jenkintown, Pa.	180	1–2.3
Schabacker Investment Mgmt Rockville, Md.	104	0.6–2
Vanguard STAR[2] Valley Forge, Pa.	628	no load no expenses
W.E. Donoghue & Co. Holliston, Mass.	40	1–2

[1]Includes four funds. [2]Fund of funds.

Many investment professionals scoff at investment newsletters. Sorry: So far as results are concerned, the best-performing letters did as well as the best mutual funds.

He who scoffs last

By Mark Hulbert

FOLLOWERS OF investment letters and fans of mutual funds seem to form two distinct subcultures. Letters typically are for activists, people who want to trade their own portfolios. Funds are for people who don't have the time to do that or who think a group of professionals can do the job better than they can. Though perhaps not as true any more with the advent of sector funds, mutual funds have been for the cautious, investment letters for the brash.

In truth, there is considerable overlap between the two groups. Nevertheless, although funds are often rated against funds and investment letters against letters, an objective comparison between the two groups has never been made.

Until now. The gap is bridged in the table below, where funds compete on an equal footing with letters. These winners form a sort of joint honor roll analogous to the honor roll that appears in the annual FORBES fund survey *(Sept. 7, 1987)*. To make the list, data from my monitoring of investment letter performance were married to fund performances based on information supplied by CDA Investment Technologies.

A lot of investment professionals will be annoyed by the results: The investment letters they profess to scorn rank right up there with the best mutual funds, in fact, taking the top three spots.

Mutual funds and investment letters can be complementary, of course. Not infrequently, letters will advise their subscribers to purchase one or more mutual funds in lieu of particular stocks or bonds. And in recent years some of the most successful letters, such as Burton Berry's *No Load Fund-X*, have been created specifically to advise subscribers when to switch into and out of mutual funds.

Still, the question for the long-term investor remains: Are letter writers just as smart as fund managers? To get an answer, I applied the FORBES mutual fund honor roll approach to both. The honor roll rewards not raw performance but performance that is consistently good in both up and down markets. Accordingly, I broke the period from July 31, 1982 to Dec. 31, 1987 into two up and two down markets.

I describe my methodology in the box on the following page. What were the results of my comparison? Seventeen mutual fund portfolios and three newsletter portfolios made the grade. But there were 342 funds for which FORBES had data covering these two market cycles, in contrast to 39 newsletter portfolios for which the HFD had sufficient performance data. The proportion of newsletters making it onto the honor roll thus was modestly

The funds versus the newsletters

Using the Forbes mutual fund honor roll approach, the Hulbert Financial Digest constructed a mutual fund-newsletter honor roll.

Mutual fund or newsletter	Grades UP	Grades DOWN	Maximum load	Annualized total return
Dines Letter (Short-Term Trading Portfolio)	B	A	2.1%	32.5%
Dines Letter (Growth Portfolio)	B	A	2.1	32.2
No Load Fund-X—Class 3 Funds	A	B	1.0	25.0
Vanguard Windsor Fund	A	A	0.0	24.8
Vanguard High Yield Stock	B	A	0.0	24.6
Dodge & Cox Stock Fund	A	B	0.0	24.4
Lehman Opportunity Fund	B	A	0.0	24.3
Fidelity Destiny Portfolio I	A	B	4.0	24.2
Phoenix Growth Fund	B	A	8.5	23.5
Federated Stock Trust	A	A	0.0	23.4
Phoenix Stock Fund	A	B	8.5	22.8
United Income Fund	A	A	8.5	22.8
Manhattan Fund	A	B	0.0	22.5
Legg Mason Value Trust	B	A	0.0	22.3
Oppenheimer Equity Income Fund	B	B	8.5	22.1
Guardian Park Ave Fund	A	B	8.5	22.1
Boston Co Capital Appreciation Fund	A	B	0.0	22.0
Merrill Lynch Basic Value Fund	B	A	6.5	21.8
Fairmont Fund	B	B	0.0	21.7
New York Venture Fund	A	B	8.5	21.6

Mark Hulbert is editor of the Washington, D.C.-based Hulbert Financial Digest *and author of* The Second Hulbert Financial Digest Almanac, *published by Minerva Books.*

The 1988 Honor Roll Open

FORBES uses three up periods and three down periods in constructing its annual mutual fund honor roll, but that would mean going back to 1978, two years before the *Hulbert Financial Digest* began monitoring newsletter performance. So I chose to look at only two market cycles.

The two up periods were July 31, 1982 to June 30, 1983 and July 31, 1984 to Aug. 31, 1987, during which times the S&P 500 gained 64.3% and 145.9%, respectively. The down periods consist of the remaining months of this 5½-year period. From June 30, 1983 to July 31, 1984 the S&P 500 lost 6%, and from Aug. 31, 1987 to Dec. 31, 1987 it lost 24.2%. (All these S&P numbers include reinvested dividends.)

The next step was to compare each mutual fund's and newsletter's performance with the S&P 500 in each period. The relative performance numbers were averaged separately for up periods and then down periods. If a fund's or letter's average relative performance in up markets placed it in the top 20% of the entire universe of funds and letters, it received a grade of A for up markets; the next 25% received a grade of B. Down markets were graded in the same way. The honor roll includes only those funds and letters that had a grade of B or better in both up and down markets and that also beat the S&P 500's gain of 188% over the full 65-month period.

This is not quite identical to FORBES' procedure. Besides using three market cycles, the annual fund survey also adjusts the performance data to reduce the possibility of an exceptionally good or bad performance in just one of the market periods to affect the fund's final grade. Weighting of the various periods was different in my four-period study than in the FORBES six-period study. But neither of these differences is likely to affect results significantly.

What about loads and costs? In deriving up and down grades, FORBES does not dock funds for loads. It does, however, require that honor roll members deliver a certain long-term performance after both loads and estimated income taxes are taken into account. My approach was slightly different. In calculating total-return figures, I reduced mutual fund performances by the size of their maximum loads and redemption fees (if any) and reduced newsletter returns by the percentage bite of 65 months' worth of subscriptions to them (assuming an initial portfolio value of $50,000). Fund loads, it is true, are generally reduced for investments above $10,000, but then newsletter subscriptions are generally much lower for multiyear subscriptions, and I figured them at their current regular annual rates.

What about trading costs? Funds' results reflect what they pay out in commissions. In monitoring advice from letters, the *HFD* assumes commission costs, too—at rates typical for individual investors, which will generally be much higher than a fund would pay. The *Hulbert Financial Digest* ratings of letters are designed to reproduce the actual experience of an investor's acting in accordance with their recommendations, allowing for such complications as mail delays, commissions, transaction costs and dividends. They are thus as comparable as I can make them with the mutual funds' real experience.—**M.H.**

higher (7.7%) than that of the mutual funds (5%).

Many newsletters offer more than one portfolio. I allowed individual portfolios onto the honor roll even when a newsletter's average performance, counting all its portfolios, did not qualify. By the same token, a fund can get on the FORBES honor roll even when its sponsor offers a lot of lousy funds as well. For example, from time to time during the 65-month period, James Dines' *Dines Letter* has recommended, besides its two winning portfolios, four additional portfolios that had inferior performances. The *Dines Letter*'s average performance would not have made it onto the honor roll. Similarly, Roy Evans' *Dow Theory Forecasts* has had three additional, weaker, portfolios.

Can a money manager improve his chance of making the honor roll by trying a lot of different portfolios? To a degree, yes. But remember that these ratings cover fairly long stretches, with both bull and bear markets. It's fairly hard to achieve the consistent performance needed merely by rolling dice over and over.

As an investment letter aficionado, I'd like to note a couple of further points.

First, because the FORBES honor roll approach puts such a high premium on consistency, it narrowly excludes two outstanding market-beating letters, Martin Zweig's *Zweig Forecast* and Dan Sullivan's *Chartist*. These services averaged annual gains of 24.4% and 22.6%, respectively, adjusting for the cost of subscription. In absolute performance that puts them 8th and 18th of all 381 funds and letters surveyed. It was for different reasons that these two letters failed to make the honor roll, however. In Sullivan's case, a C grade in down markets kept him off; his grade for up markets was B. In Zweig's case, it was his no-better-than-average gains in up markets (a grade of C) that kept him off; his superb performance in down markets earned him a grade of A+.

Second, a significantly higher proportion of investment letter portfolios (11 out of 33, or 33%) beat the S&P 500 over the entire period since I began monitoring them in mid-1980 than in the period covered in the honor roll exercise (5 of 39, or 13%). I suspect this has to do with the fact that mutual funds have a marketing incentive to be nearly fully invested most of the time, so as to reassure clients that they are getting something in return for their management fee. Letters, by contrast, have a greater willingness to get out of the market or even to go short. This helps in down markets, and the longer period since mid-1980 had more downs than the 1982-87 period studied for my honor roll. Supporting this thesis, my calculations indicate that investment letters on average significantly outperformed mutual funds in the four months after the 1987 high at an annualized rate of more than 8 percentage points.

The inescapable conclusion is that some investment letters are definitely worth listening to. Not all of them, of course, but the same can be said for mutual funds. ■

How cheap is cheap? It depends on what language you are speaking. Herewith, an international investor's guide to comparative price/earnings ratios.

Parlez-vous P/E?

By Peter Fuhrman

A PHRASE BOOK could translate the English term price/earnings ratio. But a German "Kurs/Gewinn Verhältnis" and a Japanese "kabuka/shueki ritsu" have local meanings all their own. Outside the U.S., a P/E can mean something very different from what it does on Wall Street.

In the U.S., earnings forecasts can vary, but there is little disagreement about what earnings are. Not so abroad, where it is accepted practice to doctor earnings with additions to and withdrawals from hidden reserves. In a host of other ways, earnings are distorted by accounting conventions that make it hard to compare values from one bourse to the next. But compare one must, if one has any hope of applying Benjamin Graham rationality to picking stocks rather than simply following crowds.

Jeff Hoppa

Japan. With a market capitalization of $3.5 trillion, the Tokyo Stock Exchange is the world's largest and, by U.S. standards, the most overpriced. The average P/E in Japan is 57.7, and still the locals are in a buying frenzy. It seems they care less about P/Es than they do about batting averages in the American League.

There are legitimate reasons for multiples to be higher in Tokyo. One is that accelerated depreciation is used not only on tax returns but in reports to shareholders as well. Thus, earnings are depressed and multiples made higher than they would be with American accounting. Take Mazda, the Japanese auto company 25% owned by Ford. In fiscal 1987 Mazda earned 4.75 yen a share (about 4 cents), against a price of 530 yen ($4.25), for a P/E of 111. That is far above the ratio for Ford Motor, with a trailing P/E of 5. Add back depreciation to arrive at what is commonly called cash flow, however, and you get a somewhat less dramatic difference. Mazda's cash flow is 75 yen a share, for a price/cash flow ratio of 7. That is still above Ford's price/cash flow ratio of 3, but only marginally higher than the world auto industry average.

Another perspective on the high multiples in Tokyo: Reported earnings figures often exclude earnings of partly owned subsidiaries. Look at another automaker, Honda. At 1,700 yen ($13.50), Honda shares sell at a P/E of 34. But if we consolidate earnings in subsidiaries like 36%-owned Showa Manufacturing and 40%-owned Keihin Seiki Manufacturing, Honda's multiple, according to London broker Philips & Drew, falls to 19.

But those two debating points—cash flow and subsidiary accounting—go only so far in rationalizing the far-out prices in Japan. To soothe foreigners, Japanese brokers have invented a new calculus designed to make Japanese companies look cheap. Some of their arguments would have Benjamin Graham spinning in his grave.

Perhaps the most ludicrous is that earnings per share should be calculated only on the public float. On average, 70% of a Japanese company's outstanding shares never enter the market. They are held in semipermanent escrow by banks, insurance companies and other listed companies. As a result, Japanese analysts would have

you believe, a company's earnings are spread over only 30% of the shares outstanding. This lowers the average Tokyo Stock Exchange multiple to 18 times earnings.

To take the most extreme example, by factoring out the 92% of Seibu Railway's shares held off the market by other Seibu Group companies, you can lower its P/E from the stratospheric (846) to the market average (55). Preposterous. If Seibu Railway were liquidated, would the inside holders get nothing and the minority holders claim the whole proceeds? Do the inside holders renounce dividends on their shares? Of course not.

A less ludicrous defense of Japanese share prices is the hidden-asset argument. Japanese industrials are sitting on substantial real estate and securities holdings valued at historic rather than market rates. The average Japanese company sells at 4.6 times book value. If its securities and property were valued at today's high market prices, the argument goes, shares in the same company would be selling at only a slight premium to book value.

Adjusting a book value in this fashion does make sense. But be careful not to ignore the fundamentals of the hidden assets. A piece of prime land in Tokyo the size of this page sells for something in excess of $12,000. Will these prices ever be realized by shareholders, or will real estate prices collapse first? Last year Tokyo real estate prices fell 10% in yen terms.

Be careful, too, about how you consider unrealized gains in shares of other companies. It can be a form of circular reasoning: Company A is more valuable because it owns a piece of Company B, which is more valuable because it owns part of Company A. Thus can we bootstrap the Nikkei average to an infinite valuation—until someone wants to sell escrow shares and the process works as magnificently on the way down.

"No matter what calculations you use, Japanese companies are very expensive," says Jean Brancher, the courtly general manager of Switzerland's Bank S.G. Warburg and an experienced international fund manager. "A P/E is, among other things, a reflection of confidence, and today confidence is as high in Japan as it was in the U.S. during the early 1960s. Then, Kodak was selling for 50 times earnings, just like Japanese companies today. The Japanese market was very cheap, about 5 times earnings.

High and low

There are reasons for Japanese stocks to trade higher than Swiss ones. But this much higher? At four times the price/earnings and price/book?

Country	P/E	Yield	Price/ book value
Japan	57.7	0.5%	4.64
US	13.1	3.9	1.71
Germany	12.4	4.3	1.57
Switzerland	12.4	2.7	1.27
Italy	11.9	3.3	1.44
UK	11.8	4.7	1.75
France	10.3	3.6	1.61
Netherlands	9.4	5.2	1.14
New Zealand	6.2	6.3	1.15

Source: Morgan Stanley Capital International

The Americans said, as the Japanese do now, that high prices were caused in part by a scarcity of stock. This is not true. I'm convinced that there will be a major correction at some point in Japan, just as there was in the U.S. in the 1970s."

Germany and Switzerland. Here, unlike Japan, the average multiples are below that of the U.S. market. As in Japan, complications make direct comparisons with U.S. ratios a little difficult. If accounting followed U.S. standards, reported earnings would be as much as twice as great as they are for some companies. For others, they could be a lot lower.

The cultural bias in the U.S. is toward inflating earnings. This supports share prices and fends off raiders. German and Swiss accountants have a different bias. They want to spare shareholders erratic earnings growth. In good years they push profits into various valuation reserves, hidden accounts and pension funds. They can reverse the transfers in bad years.

The shares of Switzerland's largest bank, Union Bank of Switzerland, look not unattractive at a current multiple of 16. But the shares suddenly become much more appealing when we apply U.S. accounting principles to value Union Bank earnings. PaineWebber analyst Rodney Schwartz calculates that shareholders' equity and net income would double if the bank used the accounting used by Citicorp or J.P. Morgan. If so, Union Bank, one of only seven AAA-rated banks in the world, sells for a very low 8 times earnings.

Schwartz says one way the Swiss bank understates income is by overreserving for loan losses. Like Japanese companies, Swiss companies, too, often use dividend rather than equity accounting for their subsidiaries, which keeps undistributed earnings off the balance sheet.

But hidden reserves cut both ways for a shareholder. If Union Bank's business takes a turn for the worse, we may never know it. It could inflate earnings by dipping into reserves.

What about hidden assets of German and Swiss companies, such as unrealized gains on real estate and securities? They may be substantial, but there is no way for shareholders to unlock them. Unfriendly takeovers are all but impossible in Germany and Switzerland. As in Japan, there are large cross-holdings insulating managers, such as Deutsche Bank's 28% holding in Daimler-Benz.

One more point: Switzerland and Germany both have slow-growing economies, one good reason their markets deserve to sell at a lower multiple than the U.S.'

France. France has a share-loving populace and lots of takeover activity. French accounting is roughly analogous to our own, and the average multiple is only 10.3. France's second-largest company, Peugeot, sells at less than three times trailing earnings. One negative is the country's toleration of insider trading and market manipulation. Another is the reelection of François Mitterrand.

Italy. It doesn't look too unattractive at 11.9 times earnings, especially when you consider its bustling economy. Unfortunately, with but one ex-

ception, each of the country's 20 largest companies is controlled by a single majority shareholder. What happens in a takeover? When Italy's third-largest company, Ferruzzi, took over chemical giant Montedison, it privately purchased a controlling share for 50% above the price offered to public shareholders. Now Montedison's irate public shareholders are being forced to accept the exchange of a Montedison subsidiary for some new, overpriced Ferruzzi shares. The Italian stock market is best appreciated by lovers of operatic melodrama.

Netherlands. This market, with an average multiple of 9.4, offers some of the best values. The Amsterdam exchange is the most concentrated of the world's major bourses. Three widely held Dutch giants—Royal Dutch/Shell, Unilever and Philips—make up almost 60% of the total market capitalization. Philips and Shell are both excellent investments by any standards, offering high yields (7.1% and 5.8%, respectively) and fairly strong earnings momentum.

New Zealand. A low P/E and high yield are more than offset by a weakening currency and a fairly dismal economic outlook.

No simple set of rules, and no table of ratios, will predict which markets will do best over the next several years. Investing is a matter of relative values. How does some stock look relative to this average or that historical norm? Before buying into any foreign company, at least educate yourself about P/Es in that company's home market. ■

Japanese bonds paid off handsomely for investors over the past year. A top-performing fund manager tells where he thinks the action will be now.

What Bangor is buying

By Edwin A. Finn Jr.

OVER THE LAST 12 months, few safe investments worked out better for investors than high-grade Japanese bonds. Sure, they paid what looked like anemic yields: about 4.5%. But since they were denominated in the fast-climbing yen, their market value rose in terms of the U.S. dollar. Combining interest, price gains and currency appreciation, Japanese governments returned 15% for U.S. investors.

Stacked against returns like this, the 6.5% total return last year on U.S. Treasurys looked sick.

Okay, so you want a piece of the action. You think the dollar will continue weak, and you want to buy bonds denominated in a foreign currency.

Which ones? For an answer we went to Nimrod Fachler, one of the sharpest international traders around. Returns in the foreign bond market will be tougher to come by this year, says Fachler, portfolio manager of PaineWebber Master Global Income Fund, the biggest and, for the 12 months ended Mar. 31, best-performing fund of its kind.

Fachler isn't saying the game is over. Just that with the yen, for example, having doubled in value against the dollar over the past three years, most of its action is behind us. Fachler is still confident that he can beat U.S. government bonds for a while longer by going abroad. How he plans to do it says something about the skills investors need if they want to play the international bond market on their own.

Fachler projects that the dollar will drop a further 10% against most currencies before it turns around. To make the most of this situation, he's picking his countries carefully. In Australia, Denmark, Ireland and Spain, he says, coupon rates run anywhere from five to eight percentage points higher than those offered by the stingy Germans and Japanese. Yet inflation in the former countries isn't likely to be that much worse than inflation in Japan, Fachler says. That makes the higher coupons worth the currency risk.

Just such reasoning helped Fachler's fund to a 22.2% return in its first year of operation, which ended Mar. 31. Fachler added to his results with short-term currency plays based on news events, such as politics in Australia or announcements about Britain's govern-

Global bond funds

For diversification and low transaction costs, you are better off buying a fund than individual foreign bonds—unless you have a million dollars to invest.

Fund	—Largest global bond funds— assets[1] ($mil)	12-month return[2]
PaineWebber Master Global Income	$856	21.4%
T Rowe Price International Bond	454	13.9
Merrill Lynch Retirement Global	334	13.8
Massachusetts Financial Intl Bond	177	14.5
Shearson Lehman Global Bond	164	7.0
International Cash-Global Cash	132	11.8
Templeton Income	129	6.9
Fidelity Global Bond	103	10.9

[1]As of 3/31/88. [2]Through 4/28/88. *Source: Lipper Analytical Services Inc.*

ment budget.

Fachler hopes strategies like these can deliver returns of 15% to 20% in his second year of operation. That compares with the 9% return that will come from long-term U.S. Treasurys over the next year, assuming interest rates in the U.S. stay where they are now.

There's money to be made by bond buyers who get into a weak currency just before the country concerned starts moving to stricter financial controls. And this is something that one can eventually count on to happen in almost any strong economy where the currency is weak. Why? The increasing flow of investment money across national borders is forcing policymakers to curb their spendthrift ways by slowing growth in the money supply, cutting government deficits, raising interest rates. Once they do, the local currency strengthens. Get in before it does, and you can nail down a nice capital gain.

Examples of currency geopolitics abound. The clearest case was that of François Mitterrand, who was elected president of France on his socialist pledges to nationalize large French companies. This led to a pullout of international funds, causing the French franc to weaken and French interest rates to edge up.

Before long, Mitterrand was sounding more centrist, and he has remained that way right through his recently successful election campaign. Similar capital outflows forced government austerity in Australia and New Zealand. Now international investors are asking whether the U.S. will soon be forced to trim its budget as well.

From his office near Rockefeller Center in Manhattan, sitting beneath a three-foot inflatable globe, the 35-year-old Fachler monitors inflation rates, interest rates and politics worldwide. The key barometer is inflation, which suggests the strength or weakness of a country's currency. A high inflation rate generally means a country's currency is headed for a slide. That makes it crucial to look at a foreign bond's expected real yield, which is the coupon interest rate adjusted for inflation. The exact arithmetic is a little bit trickier, but a fairly good approximation of this real yield can be obtained by subtracting the inflation rate from the annual bond yield.

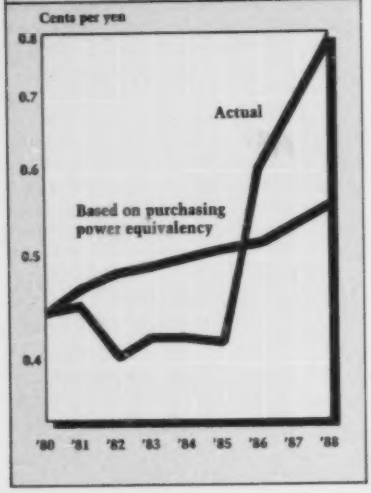
It's no accident, then, that the world's strongest currencies are in Japan and Germany, where annual inflation rates are running at about 1%. But Fachler feels that bond yields from those countries—at 4.5% and 6.5%—aren't high enough. Instead he goes for bonds denominated in currencies like the French franc, the Norwegian krone and the Danish krone. These currencies may not appreciate against the dollar as much as the mark or the yen over the long run, but, boy, they make up the difference many times over on yield. Danish long bonds, for example, yield some 12%, and Fachler feels that the currency is al-

Alex Quesada/Matrix

Nimrod Fachler, manager of the PaineWebber Master Global Income Fund
"I try to find cases where people's perception differs from reality."

Is the yen overpriced?

By one measure, it is. Since 1980 the yen has by far overcompensated for the greater inflation in the U.S than in Japan. The yen may, of course, continue its upward trajectory, but if it comes down, yen bonds will turn sour for U.S. investors.



most a proxy for the German mark.

Fachler also draws on his study of politics and European history. "I try to find cases where people's perception differs from reality," he says. "That's where you find buying opportunities." Last year Fachler made his best returns—more than 50%—in Ireland, of all places. The general perception of the Irish economy was that it was weak, inflation-ridden and badly in need of outside financing. But Fachler looked at the numbers and found the Irish to be in remarkably good shape. This, at a time when their bonds were yielding 13%.

Australia is a similar case. Americans recall getting burned on Australian bonds in 1985. The Aussie bonds were paying about 14% interest, but then the currency crashed 30% because of the government's spendthrift ways. The Australian dollar took another bad fall in 1986.

Few foreign investors fully appreciated the budget tightening subsequently undertaken by Treasurer Paul Keating. Those who did bought bonds yielding 14% in March 1987 and got a 25% kick from the rising Australian dollar. Fachler did well in Australia and right now keeps 34% of his portfolio invested there. He expects the Aussie dollar to move up some 5% against the U.S. greenback this year.

What are Fachler's sources? Travel and telephone mostly. "I get my information from people, not from newspapers," he says. One morning this year he was watching wire service reports on the U.S. bombing of Iranian oil platforms and ships in the Persian Gulf. World War III be damned, Fachler was watching his British bonds as they moved up smartly in reaction. Why? Britain's large oil holdings are beneath the North Sea, safe from the Mideast turmoil.

Earlier this year Fachler had to keep an eye on Denmark's political debate over how to keep nuclear ships out of Danish waters. The issue forced the election of a new government, which many feared would be socialist. That fear has subsided, and Fachler's Danish bonds strengthened.

Currency plays used to be a game for experts. But now, with world markets interconnected as they are and no nation a world unto itself, quite ordinary people are hedging and speculating against currency changes. One of the biggest sellers of Fachler's fund, on a per-broker basis, has been PaineWebber's Bangor, Me. office. Why Bangor? "This is really a conservative fund, and people in these places like to be conservative with their money," Fachler replies. One PaineWebber broker in the hinterland explains his selling technique: "I can tell if I have a sale in eight seconds. I call a guy up and say, 'Are you worried about the falling dollar?' If he says 'yes,' I know I have a sale."

Are you worried about the falling dollar? Do you feel that playing international currencies and interest rates through foreign bonds is a sound way to protect yourself? If so, how do you buy foreign government bonds? They come in small denominations, but some brokers tell their customers not to try to buy less than $50,000 worth at a time. To spread risk among several countries and keep commissions low, investors really need a million dollars. They also need to keep an eye on the news ticker. What if the world's finance ministers agreed to fix exchange rates? For most people, then, an international bond fund is the handiest way to play the currency sweepstakes. *(See a list of a few of the largest funds, p. 278.)* ■

If you want a really hard currency, look at Swiss stocks. Here are some hints to follow and pitfalls to avoid, from the astute managers of the Helvetia Fund.

Even Americans can yodel

By Richard Phalon

OLD SWISS BANKERS never die, they just lose interest, you say? Well, the Hottingers of Zurich have been in the business for more than two centuries now *(see box, p. 284)*, manage in excess of $1 billion of assets and are still capable of coming up with new wrinkles to capture investors' interest.

The newest and most visible manifestation of the Hottingers' interest in the U.S. is the Helvetia Fund. Its short but eventful life establishes two truths: 1) The prim Zurich Stock Exchange is no more immune to panic selling than the racetrack markets of Asia; 2) well-capitalized pros like the Hottingers prosper by clinging to a long-term point of view.

This closed-end, designed to make it easier for outsiders to slip through the barriers that fence off the Swiss

Some new issues—alas, a minority of them—are good investments. Don't play in this market unless you have the time and patience to do a lot of homework.

When the broker calls with a hot new issue

By Charles M. Bartlett Jr.

FROM 1982 THROUGH Apr. 29, 1988, during the second-greatest bull market of the century (after 1932-37), investment bankers raised $63.5 billion for America's entrepreneurs by taking 3,998 companies public. Good for the economy. Good for the companies. Good for the bankers, who kept $5.5 billion of the total as underwriting commissions and fees.

But how good was all this money raising for investors? Not very. A scan of the FORBES new-issue database establishes that the 1982-88 crop, on average, underperformed the stock market as a whole. This computation, moreover, excludes penny stocks, which tend to be the most highly manipulated and have the worst long-term results.

For our six-year study, we looked at 1,876 companies that went to the market priced at $1 or more and raised a minimum of $5 million. These larger issues raised from investors $58.8 billion, of which the investment bankers took $3.3 billion in fees. What's the market value of that $58.8 billion today? Only $64.5 billion, a 9.7% gain. You'd have done better in Treasury bills.

Only 773, or 41%, of the issues recently were selling for more than their original offering price. If new issues are compared with the stock market averages, the results are even worse. About two-thirds didn't do as well as the Standard & Poor's 500 between the date of issue and our closing date of Apr. 29. In fact, 5% of the companies went bankrupt, and 28% of the issues were down at least 50% from their offering price. A third of them left the investor with less than half the sum he'd have had holding the S&P 500 over the same period. The average relative-to-market performance was a dismal –13.6%. All of these comparisons, by the way, exclude dividends, which are much better on established S&P 500 companies than on new issues.

Patrick McDonnell

Something, nevertheless, keeps investors coming back to the new-issue market—memories of the rare jackpot. The best-performing new issue of the six years was King World Productions, distributor of such television fare as *Wheel of Fortune*, *Jeopardy* and the *Merv Griffin Show*. A $10,000 investment in King World in 1984 is now worth $115,500.

Three of the best-performing 15 companies

(see table on bottom of p. 292) also made one of FORBES' annual lists of the 200 Best Small Companies in America: Juno Lighting, Dress Barn and Par Pharmaceutical.

How do you separate the gold from the dross? Reading the prospectus carefully is a nice start. If the company has no appreciable sales, marketable product or earnings history, the prospectus is usually clear on these points. They should be red flags to the careful investor.

The other key measures to look at are the price/earnings ratio and dilution, which is the difference between what you pay for a share and the post-offering book value. Juno Lighting, number 5 on our top 20, went public in June 1983 at $12.75 a share, a hefty premium over the post-offering book value of $3.54. But at least the investor got some strong earning power. The P/E was only 12.5.

Westchester Financial Services, number 7 among the winners, is a savings bank that went public in a 1984 conversion from mutual ownership. Westchester Financial had no meaningful price/earnings ratio because a writeoff put it in the red. But there was no dilution. Quite the contrary: Westchester's investors paid $9.38 to get a share with $15.62 in book value.

Contrast those winners with Worlds of Wonder. This talking-bear firm came out in June of 1986 at $18 a share, with a P/E of 42 and a dilution of 81%. Recent price: $1. Victor Technologies, a computer manufacturer offered by L.F. Rothschild in 1983 at $17.50, is now valued in our database, charitably, at 2 cents. Another loser was the now-scandal-ridden Wedtech of the Bronx, from underwriter Moseley Securities in 1983.

Several losers were themselves underwriters. Among them was L.F. Rothschild, which went public in 1986 at $20.50 and was acquired by Franklin Savings Association this year at $2.10. Then there was Rooney, Pace, a stock jobber that raised $18 million for itself in 1983 at $8 a share. Before Rooney, Pace collapsed, wiping out common shareholders, it brought the world ZZZZ Best, a Los Angeles carpet cleaning company. ZZZZ's briefly celebrated 20-year-old chairman, Barry Minkow, as it turns out, cleaned out his shareholders and creditors.

How the investment banks performed

Investment banks with at least 10 issues brought to market between 1/1/82 and 4/29/88 are ranked by the percentage of their IPOs that outperformed the market. We include only issues of at least $5 million.

Rank	Underwriter	Number of issues	Percentage of issues that beat the market	Percentage of issues that went up	Average performance relative to market*	Average performance actual
Best						
1	Morgan Stanley	56	61%	63%	15.5%	45.3%
2	Self	85	59	60	5.5	17.4
3	First Albany	11	55	55	2.9	37.6
4	Butcher & Singer	13	54	31	–12.2	5.4
5	Interstate Securities	16	50	50	–7.4	2.7
6	Chicago Corp	12	50	42	–0.9	34.3
7	PaineWebber	83	48	55	4.4	31.4
8	Moseley Securities‡	23	48	48	0.0	20.2
9	JC Bradford	17	47	47	9.9	54.2
10	First Boston	56	46	50	4.3	35.3
Worst						
60	Rauscher Pierce Refsnes	14	7	21	–35.0	–14.2
59	Rotan Mosle†	11	9	9	–52.8	–41.2
58	Bateman Eichler	11	9	36	–45.2	–22.9
57	Rooney, Pace‡	15	13	20	–57.5	–41.9
56	Hambrecht & Quist	73	18	33	–34.9	–6.1
55	Prescott Ball & Turben	16	19	38	–34.9	–11.9
54	Ohio Co	10	20	10	–38.8	–27.1
53	Tucker Anthony & RL Day	20	20	35	–18.2	–9.3
52	Janney Montgomery Scott	10	20	40	–29.0	–3.9
51	Dain Bosworth	24	21	29	–28.3	–6.6

*The percentage by which the ending value of $100 invested in the stock exceeds the ending value of $100 invested in the market. †Subsidiary of PaineWebber. ‡Chapter 11.

Whence come the best new issues? In the table above, we rank the investment bankers by the percentage of their stocks that outperformed the S&P 500.

Number one is Morgan Stanley, the once stodgy investment banking firm that of late has been leaving mighty houses like Salomon Brothers in the dust in terms of efficiency, deals and earnings potential. Almost 61% of the 56 companies it brought public outperformed the S&P 500. Among its stars: Jefferson Smurfit, in paper and packaging, up 385%; 3-COM, communications, up 231%; and Acuson, medical imaging, up 225%.

Self underwritings, issues that were brought public by the issuers themselves, outperformed every investment banking house but Morgan Stanley. Surprising? Only until you realize that a good number of these self underwritings were savings and loans converting from mutual ownership. In many cases they gave their depositors first crack at the stock in the conversion, so the numbers we compute for overall new-issue performance are, if anything, slightly too kind to the new-issue market.

As in previous surveys, we found that some of the best new-issue product comes from regional firms. Perhaps keeping close to your suppliers is an advantage in this business. Five of the top 10 underwriters are small, regional firms *(see table, above)*. Buying from an underwriter with a good performance record is no guarantee of success, but it surely beats buying from an underwriter with a terrible record.

The biggest underwriters

Shearson and the brokers it has acquired have managed 288 initial offerings since January 1982. Below, the 10 largest underwriters.

Rank	Underwriter	Number of issues	Percentage of issues that beat the market	Percentage of issues that went up	Average performance relative to market*	Average performance actual
1	**Shearson Lehman Hutton**	115	42%	51%	–3.9%	21.4%
	EF Hutton	95	39	53	0.8	46.6
	Robinson-Humphrey	45	33	44	–14.3	5.6
	Lehman Bros Kuhn Loeb	31	29	55	–16.1	41.6
	Foster Marshall-Am Exp	2	50	50	–6.7	81.3
2	**Merrill Lynch**	180	43	49	–7.6	16.2
	Becker Paribas	27	26	52	–30.2	27.7
3	**Alex Brown & Sons**	140	43	45	–7.7	12.6
4	**Drexel Burnham Lambert**	137	37	42	–12.6	3.4
5	**Kidder, Peabody**	87	37	43	–10.8	16.6
6	**PaineWebber**	83	48	55	4.4	31.4
	Rotan Mosle	11	9	9	–52.8	–41.2
7	**LF Rothschild**	82	28	35	–19.8	14.9
8	**Goldman, Sachs**	80	39	49	2.4	23.0
9	**Prudential-Bache**	80	23	33	–28.3	–5.5
10	**Dean Witter Reynolds**	76	38	50	–7.1	33.6

More important is the homework you do in comparing a new issue to established issues in its industry. Analysis is always key to success in investing, but that goes double for new issues. The reason is that the market for established companies is rendered at least fairly rational, if not perfectly efficient, by the constant buying and selling by institutions, astute individuals and professional short-sellers. Ford Motor could go way up or down from its recent price of $49, but chances are that an intelligent appraisal of its prospects would not find the company worth only half that $49.

The same cannot be said for a new issue, which can be peddled to naive investors for several times its intrinsic value if the brokers work the telephones hard enough. If you're not prepared to spend several hours with the prospectus for a new issue, or if you don't have a good feel for how to compare a company's fundamentals with those of its competitors, don't buy. ■

The best performers

Below, the 15 best-performing new issues from 1/1/82 through 4/29/88, based on actual performance. We have not counted issues that were offered below $1 or that raised less than $5 million.

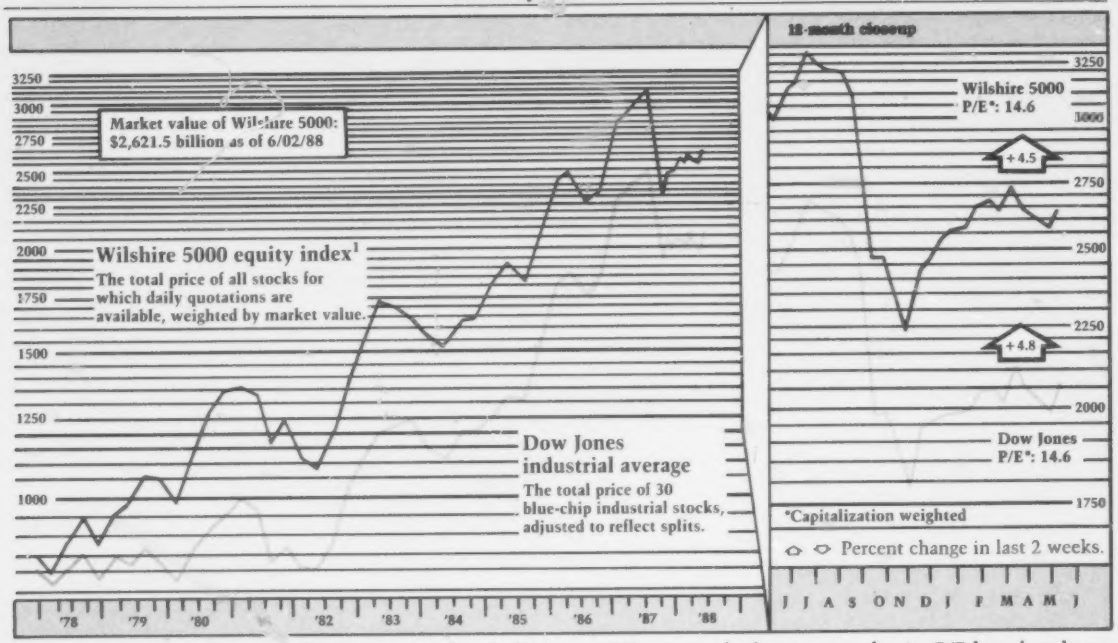
Company/business	Offer[1] price	Recent price	Offer value ($mil)	Offer date	% gain actual	% gain relative to market*	Underwriter
King World Productions/film dist	$1.67	19¼	$12.5	12/5/84	1,055%	616%	PaineWebber
Washington Federal/savings & loan	2.88	25	11.1	11/9/82	856	423	EF Hutton
AL Williams Corp/insurance-life	1.60	14⅛	8.9	7/7/82	783	262	Self
Autodesk/computer software	3.67	28¼	15.4	6/28/85	670	466	LF Rothschild
Juno Lighting/lighting fixtures	3.19	20⅝	8.3	9/1/83	547	307	William Blair
Adobe Systems/computer software	5.50	35	5.5	8/13/86	536	498	Hambrecht & Quist
Westchester Financial[2]/savings bank	9.38	53	15.0	3/12/84	465	238	First Bos; Shearson; Thomson McKinnon
Dress Barn/apparel stores	2.00	12½	23	5/4/83	444	240	Lehman, Kuhn Loeb
Total System Services/bank card process	3.33	18	7.5	8/10/83	440	234	JC Bradford
Home Owners Svgs & Loan/savings & loan	2.96	15½	7.3	5/25/84	423	203	Bear, Stearns
Par Pharmaceutical/drugs-generic	3.33	17⅜	8.2	12/2/83	421	230	Ladenburg Thalman
Microsoft/computer software	10.50	54½	58.7	3/13/86	419	363	Goldman, Alex Brown
Sigma Designs/computer products	2.88	14½	5.7	5/17/86	404	349	Laidlaw Adams & Peck
Coastal Savings Bank[3]/savings & loan	7.38	36¾	5.0	7/3/84	398	193	Pru-Bache; Burgess & Leith
Westwood One/radio systems	4.60	22¾	14.5	4/26/84	394	203	Hambrecht & Quist

*The percentage by which the ending value of $100 invested in the stock exceeds the ending value of $100 invested in the market. [1]Per common share; adjusted for splits. [2]Acquired by Marine Midland. [3]Acquired by Suffield Financial.

Sources: Forbes, IDD Information Services, Wilshire Associates.

The Forbes/Wilshire 5000 Review

Edited by Steve Kichen



Good news bears. Bad news bulls. With more than half of all investment advisers bearish, it was no surprise that the stock market moved higher. The activity, however, was focused on large-capitalization issues. Over the last two weeks the Dow moved up 4.8% and the NYSE gained 4.7%. Amex and Nasdaq shares were up 2.5% and 2.3%, respectively.

Corporate earnings were up sharply in the last quarter. While the Wilshire index of nearly 5,700 securities posted a 4.5% gain in the last two weeks, its P/E based on latest 12-month earnings fell from 15.1 to 14.6. The unexpected strength of the economy in the first three months of the year had caused worries on Wall Street about a resurgence of inflation. The news that April consumer spending was flat helped to set off a 75-point Dow rally.

These are the times that try common sense—when strength in the economy is cause for worry and flat sales are taken as reason to cheer.

Closeup On the Equity Markets

Performance of six leading indexes

Percent change	Wilshire 5000	Forbes 500[2]	Dow Jones industrials	NYSE Composite	Amex Market Value Index	NASDAQ Composite
in last 4 weeks	1.8	2.6	1.6	2.2	–1.1	–1.3
in last 52 weeks	–9.9	–9.9	–12.2	–9.9	–9.1	–10.2

Stock performance based on six key investor yardsticks

Percent change	Company size		Volatility[3]		P/E multiple		Dividend yield		Growth profile[4]		Share price	
	large	small	high	low	over 25	under 5	over 7.5%	none	high	low	over $40	under $4
in last 4 weeks	2.3	0.3	1.7	1.8	–0.2	–0.7	1.9	1.0	0.6	1.4	1.0	–0.6
in last 52 weeks	–4.2	16.2	14.8	5.6	–4.2	–1.3	0.0	20.3	14.4	4.7	–1.0	13.1

[1]Wilshire index reflects price performance. It differs slightly from market value of outstanding stocks because of retirements of equity since index was created. [2]Based on sales. [3]A stock's sensitivity to overall market movement. High-volatility issues have wide price fluctuations, low-volatility issues are more stable. [4]A quantitative evaluation of a stock's growth image, determined by Wilshire Associates.

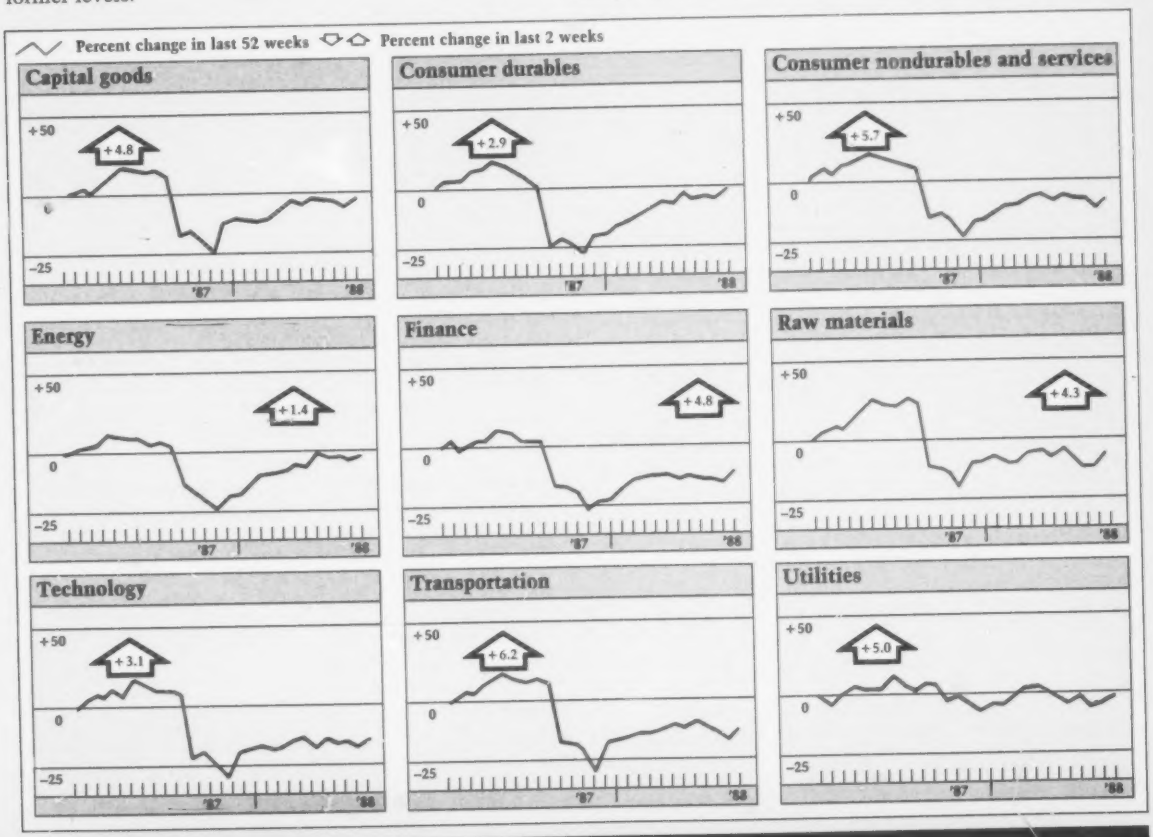
Note: All data for periods ending 6/02/88. Prepared by Wilshire Associates, Santa Monica, Calif.

Steven Ramos

Where the Action Is

Short circuit. The technology group shows an 18.3% loss over the last 52 weeks. Since the market peaked late last August, technology stocks are off more than 27%. Prior to the crash many technology stocks were selling at outrageous price-to-earnings and price-to-sales ratios *(see p. 210)*. Many of these stocks now sell well below their former levels.

Sector results, remember, are capitalization-weighted. It's the big companies' performance that hurt. IBM, recently trading at 112⅝, was going for 172 when the market peaked last August. With more than 597 million shares outstanding, the 34% decline in IBM removed more than $35 billion in market value, 28% of the technology sector's decline.



What the Analysts Think

Estimates are climbing for consumer durables and energy. In the past four weeks analysts upped 1988 estimates for the two groups by 7.9% and 4.6%, respectively. Occidental Petroleum shows the biggest percentage change among energy stocks, with estimates of its per-share earnings rising 44% in the past four weeks, from $1.04 to $1.50.

Forecasting the Forbes Sales 500

Performance period	Average earnings per share	P/E
latest 12 months	$2.79	13.6
1988 estimates	3.56	10.6
1989 estimates	3.94	9.7

Rank based on change in estimate	Sector	Estimated 1988 EPS	Estimated 1988 P/E	% change in 1988 estimate in 2 weeks	% change in 1988 estimate in 4 weeks
1	Consumer durables	$4.35	11.8	3.74%	7.88%
2	Energy	2.99	12.9	3.12	4.61
3	Raw materials	3.02	10.4	2.68	4.70
4	Transportation	2.48	10.9	0.57	0.73
5	Capital goods	2.58	14.3	0.31	0.92
6	Technology	2.87	11.6	0.24	0.62
7	Consumer nondurables	2.54	12.6	0.00	0.03
8	Utilities	2.41	10.0	–0.33	–0.46
9	Finance	3.43	8.0	–0.53	–0.29

Earnings projections are capitalization-weighted consensus estimates from over 3,000 security analysts. Data are compiled and updated continually by the Institutional Brokers Estimate System (IBES), a service of Lynch, Jones & Ryan, a New York-based brokerage firm.

Note: All data for periods ending 6/02/88. Prepared by Wilshire Associates, Santa M[illegible] service of Lynch, Jones & Ryan, New York.